BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
CARLO MARCHETTI, SR., AND LOLA MARCHETTI)
CARLO MARCHETTI, JR., AND LAUREL MARCHETTI)
DANTE GIURLHNI)

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law

For Respondent: F. Edward Caine, Senior Counsel

O P I N I O N

These appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Carlo Marchetti, Sr., and Lola Marchetti in the amounts of $272.56, $464.32 and $668.74 for the years 1952, 1953 and 1954, respectively; against Carlo Marchetti, Jr., and Laurel Marchetti in the amounts of $262.86, $412.74 and $626.09 for the years 1952, 1953 and 1954, respectively; and against Dante Giurlani in the amounts of $486.05, $761.70 and $1,156.65 for the years 1952, 1953 and 1954, respectively.

During the period in question Appellants Carlo Marchetti, Sr., Carlo Marchetti, Jr., and Dante Giurlani were partners in an enterprise known as the Rendezvous Music Company. Rendezvous operated a coin-machine business near Rio Dell, Humboldt County. It owned multiple-odd bingo pinball machines, flipper pinball machines and music machines. There is also some indication that it acquired by rental one or more claw machines but apparently they were not retained for long. The equipment was placed in restaurants, taverns and other locations. The proceeds from each machine, after the allowance of expenses claimed by the location owner in connection with the machine, were divided equally between Rendezvous and the location owner. Equipment was placed in approximately 40 locations.

The gross income reported in Rendezvous Music Company's returns was the total of amounts retained by Rendezvous from locations. Deductions were taken for depreciation, cost of phonograph records and other business expenses.

Respondent determined that Rendezvous was renting space in the locations where its machines were placed and that all the coins deposited in the machines constituted gross income to

Rendezvous. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between Rendezvous and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197; 3 P-H State & Local Tax Serv. Cal, Par, 58,145. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

As we also held in Hall, if a coin machine is a game of chance and cash is paid to winning players, the operator is engaged in an illegal activity within the meaning of Section 17359. The multiple-odd bingo pinball machines here involved are substantially identical to the machines which we held to be games of chance in Hall.

Although the evidence as to cash payouts is not without conflict, two location owners testified that they made cash payouts, one of the partners and a collector employed by Rendezvous testified that they assumed cash payouts were being made, and the machines were equipped to record free games not played off.

From the evidence before us, we conclude that it was the general practice to make cash payouts to players of these machines for free games not played off. Accordingly, these machines were operated illegally and Respondent was correct in applying Section 17359.

The evidence indicates that collections from all types of machines and repairs to all types of machines were made principally by one of the partners and by an employee. Neither specialized in certain types of equipment. Furthermore, many locations serviced by Rendezvous had both a music machine and a pinball machine. We thus find that there was a substantial connection between the illegal activity of operating multiple-odd

bingo pinball machines and the legal activity of operating amusement machines. Respondent was, therefore, correct in disallowing all deductions for expenses of the entire business.

The collector for Rendezvous prepared a collection report at the time of each collection and left a copy with the location owner. The amounts included on the reports were the net proceeds after exclusion of the amounts claimed by the location owners for expenses. Since there were no complete records of amounts paid to winning players and other expenses initially paid by the location owners, Respondent made an estimate of the unrecorded amounts.

At the time of making the audit in 1956, Respondent's auditor interviewed several owners of locations in which multiple-odd bingo pinball machines acquired from Rendezvous were operated during the years in question. Four of these location owners stated that cash payouts were made to winners and also gave estimates of the percentage which the payouts bore to the total amounts deposited in the machines. One estimate was 70% two were 50% and one was 30%. Based on these estimates, Respondent estimated the cash payouts to have been equal to 50% of the total amounts deposited in the multiple-odd bingo pinball machines.

The Rendezvous records did not indicate income by type of machine. From an analysis of the collection reports and other records, Respondent's auditor estimated that of the total recorded gross income for 1952, 50% was derived from multiple-odd bingo pinball machines, 40% from music machines and 10% from other types of equipment. His estimates for 1953 were 55%, 40% and 5%, respectively, and for 1954 they were 65%, 30% and 5%, respectively.

Respondent derived its estimates of unrecorded payouts by combining the 50% payout estimate with its estimates of the percentages of income attributable to the multiple-odd bingo pinball machines. As we also held in Hall, supra, Respondent's computation of gross income is presumptively correct. Appellants have not offered any evidence that Respondent's computation is erroneous, or any suggestion of a more accurate method of estimating gross income than that used by Respondent. Respondent's method of estimation was reasonable under the circumstances and, therefore, except for the reduction due to our conclusion that Rendezvous and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

Appeals of Carlo Marchetti, Sr., and Lola Narchetti, et al.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Carlo Marchetti Sr., and Lola Marchetti in the amounts of $272.56, $464.32 and $668.74 for the years 1952, 1953 and 1954, respectively; against Carlo Marchetti, Jr., and Laurel Marchetti in the amounts of $262.86, $412.74 and $626.09 for the years 1952, 1953 and 1954, respectively; and against Dante Giurlani in the amounts of $486.05, $761.70 and $1,156.65 for the years 1952, 1953 and 1954, respectively, be and the same is hereby modified in that the gross income is to be recomputed in accordance with the Opinion of the Board. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 6th day of November, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary